SETTING THE RIGHT EXAMPLE

There has been plenty of talk globally about the need for banks to return to traditional values and operating models to avoid future financial turmoil. Malta is following this path and is reaping the rewards for its conservatism.

WRITER Michael Imeson

Despite the worldwide financial crisis and incipient economic recession, some European countries have escaped the worst effects. Malta is one of them. This Mediterranean island, only 316 square kilometres in size and with a population of 410,000, has suffered no systemic shocks and no banking failures.

One reason is that Malta has stuck to conventional banking. Its banks have benefited from an approach based on old-fashioned intermediation between retail depositors and borrowers. They have not relied on wholesale funding and they have substantial liquidity, adequate capital and prudent lending policies.

Malta’s economy – although dependent on trade, manufacturing exports, tourism and financial services, all of which are feeling the effects of the global downturn – is resilient. Its economy was still growing in the third quarter of 2008 and was projected to end 2008 with 2.5% annual growth. Although the pace will slow in 2009, it is forecast to achieve more than 1% growth.

SIGNIFICANT PROGRESS
Malta has made great progress since the 1990s in establishing itself as a vibrant regional financial centre, especially since joining the EU in 2004. Broadly defined, the finance sector accounts for 12% of the country’s gross domestic product. The government’s ambition, articulated in ‘Vision 2015’, is for this figure to rise to 25% by 2015.

The country provides a tax-efficient and relatively low-cost base for foreign banks, insurance companies, wealth managers, fund managers, fund administrators, international pension scheme providers and other financial firms looking for an EU-compliant yet flexible domicile. Malta adopted the euro last year, which means that the Maltese economy did not have to be protected against capital flights to safer currencies. Transactions across the euro area take place without any exchange rate risk, although Malta’s open economic policies have, for a long time, allowed companies the choice of running their operations in the predetermined major currency of their choice.

TRADITIONAL VALUES
Michael Bonello, governor of the Central Bank of Malta, says that the country’s good fortunes when others are struggling is due partly to its small size and “relative detachment from the mainstream”, but mainly because “our banking system is traditionally conservative, which is what banking is supposed to be about”.

Banks in other countries have moved so far from basic principles that a new generation of bankers is discovering these principles for the first time, he says. “Bank funding in Malta depends on retail deposits not wholesale borrowing, and banks lend to borrowers with whom they maintain a lifelong relationship,” says Mr Bonello. “If you look at the loan-to-deposit ratio for Malta’s banks, it is about 77%. The ratios are nowhere near those in the US or the UK. Our banks take good collateral too.”

Banks’ investment policies have been prudent. “They have diversified portfolios,” he says. “One of our banks lost money on some Lehman Brothers bonds, but they weren’t junk bonds. Maltese banks didn’t buy any asset-backed securities. Their fundamental banking business is sound. Their profitability is good, and their return on assets and equity is good. They have strong liquidity – the average ratio is about 48% – and the capital adequacy average is 14% to 15%. So there was no reason for the contagion to reach us.” But he
does sound a note of caution. There will be second-round effects on the banking system if the global recession is long and deep, and inevitably this will affect the Maltese economy, including its financial sector.

The other main event of 2008 for the financial sector was adopting the euro. “It wasn’t a ‘big bang,’” says Mr Bonello. “At the Central Bank of Malta, we had been preparing for it for years, changing our information technology and accounting systems and management structures. On January 1 last year we just flicked the switch and were able to start reporting daily balance sheet and other information to the European Central Bank [ECB]. Our banks started to participate in the monetary operations of the ECB quite soon after. We didn’t have any major glitches,” he adds.

EU-COMPLIANT REGULATION
Malta has a single regulator, the Malta Financial Services Authority (MFSA), chaired for the past 10 years by Professor Joseph Bannister. “As an EU member, we have more or less the same regulatory model as other member states,” says Mr Bannister. “But we have been careful not to make it too prescriptive. In certain situations, EU directives do allow flexibility.

“We are moving towards a more risk-based approach. We constantly review regulation and, from time to time, remove what is no longer required. We also look at regulation in conjunction with the needs of our clients, and where we can be flexible, we are.” He believes that the MFSA’s responsibilities include providing a service to clients.

This does not make the MFSA a soft touch. It runs a tightly controlled regime, and gets close to all of those that it regulates and supervises. That closeness has a dual benefit – it gives the MFSA a better understanding of the soundness of licence holders, which allows it to be adaptable when it can.

“One of the fault lines that has developed in the global financial system is that regulators may have become somewhat detached from the people they regulate, whereas we have never become detached from them,” says Mr Bannister. “It is a policy of ours that anyone who seeks a licence from us has to meet the regulator beforehand, discuss the issues and then make the application.”

NO TOXIC ASSETS
Bank of Valletta (BoV), one of Malta’s top two banks, reported a €40.6m pre-tax profit for its financial year ending September 2008, down on the €101.6m reported in 2007, which is considered “respectable” in the circumstances. It had to write off €12.7m of Lehman Brothers’ debt and, under fair value accounting rules, had to mark down €81m in other securities held.

These were the only significant adverse effects of the financial crisis felt in Malta. “Maltese banks didn’t have any toxic assets, and are liquid and adequately capitalised,” says Tonio Depasquale, BoV’s chief executive. “It was always our policy to have very high-quality assets which are also liquid. Our advances-to-deposit ratio is very conservative at 67%, especially when compared with other international banks, whose lending well exceeds their deposits,” he adds. “In 2008, BoV was, for the first time, the biggest lending bank in Malta. Yet we have reduced non-performing loans to less than 4% from 12% four years earlier. We have managed to substantially increase our loan portfolio while simultaneously improving the quality.”

HSBC Bank Malta is the country’s other main bank, and will report a higher profit than BoV for 2008. “Banks here are not reliant on wholesale funding and tend to have strong, sticky deposit bases,” says Alan Richards, HSBC Malta’s chief executive. “The central bank, government and MFSA, to their credit, have developed a well-regulated market. Although the global and European economic downturn will leave its mark on Malta, the well-regulated nature of the market and the lower gearing of Maltese banks should protect it from the worst of the direct consequences of the financial crisis.”

Margrith Lütschg-Emmenegger, the president of FIMBank – a trade finance specialist which set up its Malta head office in the 1990s – says that liquidity has been tighter and more expensive in 2008, but business has been good. “As we are a trade finance bank, we haven’t experienced any credit issues so far,” she says. “We also do not generally have significant mark-to-market issues.”

“The only problem is that banks are not providing many borrowing lines so we have to use our own deposit base and own funds to do business. We are doing less business, but it’s more profitable,” says Ms Lütschg-Emmenegger. Profit for 2008 will be much better than 2007, partly due to the sale of its factoring business in India. “We have positioned ourselves so that 2009 should be another good year, though most likely not as good as 2008. We already have factoring operations in Egypt, Jordan and Pakistan, and plan to start new factoring joint ventures in Vietnam and Brazil this year, as well as returning to India with the factoring product.”

REGIONAL FINANCE CENTRE
The number of banks based in Malta has risen from 16 in 2004 to 23 in September last year. During the same period, total assets in the banking system more than doubled to €45.1bn. There has been growth in other sectors too. The number of local and foreign-based collective schemes has climbed from about 70 in 2004 to nearly 400, partly reflecting legislative changes that spurred the formation of professional investor funds. Total assets under management have increased exponentially to more than €9bn. The insurance sector has trebled in size during the past three years, mainly through increased international and captive insurance business.

Joseph Zammit Tabona, chairman of FinanceMalta, the public-private partnership set up two years ago to promote the island as a financial centre, points to Malta’s numerous strengths, including its strategic location at the heart of the Mediterranean, eurozone membership, relatively low costs, attractive tax regime, good lifestyle and rich heritage. All legislation is published in English as well as Maltese, as English is one of its two official languages.

“However, it is what others say about us that’s most telling,” says Mr Zammit Tabona. Perhaps his favourite testimonial is the Global Financial Centres Index, published by the City of London last March. It ranked Malta fourth out of 66 jurisdictions as a centre “that is most likely to increase in importance over the next few years”, behind only Dubai, Shanghai and Singapore. It also ranked Malta fifth in “top financial centres, where organisations may open new operations in the next two to three years”, behind Dubai, Luxembourg, Singapore and Mumbai.

Financial Times Global Events is organising a “Financial Services in Malta” conference on March 26 in London. The Banker is the media partner. For details visit www.ftglobalevents.com and click on “Upcoming events”. Tel: +44 (0)20 7775 6653.